

DIRECT TESTIMONY
OF
LAFAYETTE K. MORGAN, JR.

ON BEHALF OF THE
SOUTH CAROLINA DEPARTMENT OF CONSUMER AFFAIRS
CORRECTED

JANUARY 23, 2020

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Introduction

Q. WOULD YOU PLEASE STATE YOUR NAME AND BUSINESS ADDRESS?

A. My name is Lafayette K. Morgan, Jr. My business address is 10480 Little Patuxent Parkway, Columbia, Maryland, 21044. I am a Public Utilities Consultant working with Exeter Associates, Inc. Exeter is a firm of consulting economists specializing in issues pertaining to public utilities.

Q. PLEASE DESCRIBE YOUR EDUCATIONAL BACKGROUND AND QUALIFICATIONS.

A. I received a Master of Business Administration degree from The George Washington University. The major area of concentration for this degree was Finance. I received a Bachelor of Business Administration degree with concentration in Accounting from North Carolina Central University. I was previously a CPA licensed in the state of North Carolina but elected to place my license in an inactive status as I pursued other business interests.

Q. WOULD YOU PLEASE DESCRIBE YOUR PROFESSIONAL EXPERIENCE?

A. From May 1984 until June 1990, I was employed by the North Carolina Utilities Commission - Public Staff in Raleigh, North Carolina. I was responsible for analyzing testimony, exhibits, and other data presented by parties before the North Carolina Utilities Commission. I had the additional responsibility of performing the

1 examinations of books and records of utilities involved in rate proceedings and
2 summarizing the results into testimony and exhibits for presentation before that
3 Commission. I was also involved in numerous special projects, including participating
4 in compliance and prudence audits of a major utility and conducting research on several
5 issues affecting natural gas and electric utilities.

6 From June 1990 until July 1993, I was employed by Potomac Electric Power
7 Company (Pepco) in Washington, D.C. At Pepco, I was involved in the preparation of
8 the cost of service, rate base and ratemaking adjustments supporting the company's
9 requests for revenue increases in the State of Maryland and the District of Columbia. I
10 also conducted research on several issues affecting the electric utility industry for
11 presentation to management.

12 From July 1993 through 2010, I was employed by Exeter Associates, Inc. as a
13 Senior Regulatory Analyst. During that period, I was involved in the analysis of the
14 operations of public utilities, with particular emphasis on utility rate regulation. I
15 reviewed and analyzed utility rate filings, focusing primarily on revenue requirements
16 determinations. This work involved natural gas, water, electric and telephone
17 companies.

18 In 2010, I left Exeter to focus on start-up activities for other business interests.
19 In late 2014, I returned to Exeter to continue to work in a similar capacity to my work
20 prior to my hiatus.

21

1 **Q. HAVE YOU PREVIOUSLY TESTIFIED BEFORE THIS COMMISSION, OR**
2 **OTHER STATE COMMISSIONS? IF SO, WHICH COMMISSIONS?**

3 **A.** I have previously presented testimony and affidavits on numerous occasions before the
4 North Carolina Utilities Commission, the Pennsylvania Public Utility Commission, the
5 Virginia Corporation Commission, the Louisiana Public Service Commission, the
6 Georgia Public Service Commission, the Maine Public Utilities Commission, the
7 Kentucky Public Service Commission, the Public Utilities Commission of Rhode
8 Island, the Vermont Public Service Board, the Illinois Commerce Commission, the
9 West Virginia Public Service Commission, the Maryland Public Service Commission,
10 the Oklahoma Corporation Commission; the Public Service Commission of Delaware;
11 the Philadelphia Water, Sewer and Storm Water Rate Board; the Kansas Corporation
12 Commission; the Colorado Public Utilities Commission; and the Federal Energy
13 Regulatory Commission. My resume is attached hereto as Exhibit A.

14
15 **Q. ON WHOSE BEHALF ARE YOU PROVIDING THIS TESTIMONY?**

16 **A.** I am presenting testimony on behalf of the South Carolina Department of Consumer
17 Affairs (the “Consumer Advocate”).
18
19
20
21
22

1 **Q. WHAT IS THE PURPOSE OF YOUR DIRECT TESTIMONY IN THIS**
2 **PROCEEDING?**

3 **A.** Exeter Associates has been retained by the South Carolina Department of Consumer
4 Affairs to assist in the evaluation of the General Rate Filing submitted by Blue Granite
5 Water Company (“BGWC” or the “Company”). I have been asked by the Consumer
6 Advocate to determine the level of revenues that BGWC should be authorized in this
7 proceeding. In this testimony, I present my findings regarding BGWC’s test year rate
8 base and net operating income at present rates. Based on these amounts, I have
9 determined the revenues that are required to generate the overall rate of return on rate
10 base recommended by Mr. Aaron L. Rothschild on behalf of the Consumer Advocate.

11
12 **Q. IN CONNECTION WITH THIS CASE, HAVE YOU PERFORMED AN**
13 **EXAMINATION AND REVIEW OF THE COMPANY’S TESTIMONY AND**
14 **EXHIBITS?**

15 **A.** Yes. I have reviewed BGWC’s testimony, exhibits and its rate filing. I have also
16 reviewed the Company’s responses to discovery requests propounded by the Office of
17 Regulatory Staff (ORS).

1 **Q. HAVE YOU PREPARED SCHEDULES TO ACCOMPANY YOUR**
 2 **TESTIMONY?**

3 **A.** Yes. I have prepared Exhibits LKM-1 through LKM-4. These exhibits present a
 4 summary of my findings regarding the revenues and expenses under present and
 5 proposed rates. My exhibits are based upon a modification of the electronic version of
 6 Blue Granite's revenue requirements model.

7
 8 **Summary and Recommendations**

9 **Q. PLEASE SUMMARIZE THE RATE RELIEF REQUESTED BY BLUE**
 10 **GRANITE IN ITS FILING.**

11 **A.** On October 2, 2019 the Company filed its application seeking a combined water and
 12 wastewater revenue increase of \$11,731,803. The Chart below presents a summary of
 13 the proposed increases in each of the service categories.

Blue Granite Water Company Summary of Proposed Revenue Increases		
	Proposed Revenue Increase	Proposed Percentage Increase
Water Service Revenues - Territory 1	\$ 3,636,850	53.5%
Water Service Revenues - Territory 2	1,939,107	34.9%
Consolidated Sewer Service Revenues	6,155,846	55.7%
Total Operating Revenues	<u>\$11,731,803</u>	

14

15 In this filing, the Company is requesting that its rates be determined on the return on
 16 rate base method. Accordingly, BGWC is seeking to earn an overall return of 8.36

1 percent on its rate base. The rate increase filing is based on the historical test year
2 ended June 30, 2019.

3 In addition to the proposed rate increase, the Company has made several
4 proposals for recovery of costs and other initiatives that may have a direct impact on
5 the determination of the revenue requirement in this proceeding. First, the Company is
6 seeking recovery of the balance in the deferred account associated with increases in
7 purchased water from third-party bulk water and sewer treatment providers. BGWC
8 explains that in Order No. 2015-876 in Docket No. 2015-199-WS, this Commission
9 approved two regulatory deferred accounts authorizing the Company to record and
10 monitor all rate increases from third-party providers for water supply and sewer
11 treatment, and this Commission also authorized the Company to seek recovery of the
12 balance of these deferred accounts, subject to audit by the ORS and approval by this
13 Commission in a subsequent rate case.

14 Second, the Company requests Commission approval of an annual rate
15 adjustment mechanism for purchased water and sewer treatment expenses. This pass-
16 through mechanism would initiate a rate adjustment between base rate filings to recover
17 the deferral of changes in third-party service provider rates.

18 Third, the Company is requesting the amortization and recovery of litigation
19 expenses related to two Administrative Law Court (“ALC”) cases (the DHEC Permit
20 Denial case and I-20 Interconnection case) which this Commission authorized the
21 Company to defer in Docket No. 2017-292-WS, Order No. 2018-802.

1 Fourth, the Company seeks Commission authority to defer, as a regulatory
2 asset, the capital costs to remove decommissioned plant assets, as well as the remaining
3 net book value for such assets as of the time of removal from service. The Company
4 also seeks to include the regulatory asset in rate base and to amortize the regulatory
5 asset as an expense in the revenue requirement.

6 Fifth, BGWC proposes to initiate a one-time credit of \$10.64 to each customer
7 water and sewer service account, to return overcollections of federal income tax
8 expenses accumulated between January 1, 2018 to June 28, 2018 related to the Tax
9 Cuts and Jobs Act (TCJA). The TCJA lowered the federal corporate income tax rate
10 from 35% to 21%.

11 Sixth, BGWC proposes to implement a voluntary “Round Up” program, which
12 would round participating customer bills to the nearest higher dollar, with the
13 difference being accumulated in a reserve fund for remittance to the South Carolina
14 Office for Economic Opportunity. The funds would be distributed to Community
15 Action Agencies in the Company’s service territory to assist low income customers
16 with their water and sewer bills. The Company also seeks approval to defer
17 implementation costs for the Round Up program related to modifications of its billing
18 system and MyUtilityConnect customer service application for recovery in the
19 Company’s next base rate case.

20 Finally, the Company seeks Commission authority to adjust its existing
21 depreciation and amortization rates, as presented in its application.
22

1 **Q. WHAT TIME PERIOD HAVE YOU USED IN MAKING YOUR**
2 **DETERMINATION OF BLUE GRANITE’S REVENUE REQUIREMENTS?**

3 **A.** I have used the actual test year ended June 30, 2019 as the basis for determining
4 BGWC’s rate year revenue requirements. This is the same test year used by the
5 Company in its filing.

6 **Q. PLEASE SUMMARIZE YOUR FINDINGS AND RECOMMENDATIONS.**

7 **A.** As shown on Exhibit LKM-1, I have determined the Company has a revenue deficiency
8 of \$6,979,049 for the test year ended June 30, 2019. This represents a decrease of
9 \$ 4,752,754 when compared to BGWC’s requested increase of \$11,731,803. This is
10 the amount by which revenues exceed those required to generate an overall rate of
11 return of 7.27 percent after accounting for the Consumer Advocate’s adjustments to
12 BGWC’s claimed rate base and operating income. The return of 7.27 percent
13 represents the Consumer Advocate’s witness Rothschild’s finding regarding the
14 Company’s overall rate of return.

15 **Q. HOW IS THE REMAINDER OF YOUR TESTIMONY ORGANIZED?**

16 **A.** In the remainder of my testimony, I document and explain each of the adjustments to
17 rate base and operating income that I have made to arrive at the rate year revenue
18 deficiency as shown on Exhibit LKM-1. My discussion of these adjustments is
19 organized into sections corresponding to the issue being addressed. These sections are
20 set forth in the Table of Contents for this testimony.

Post-Test Year Land Purchase

Q. PLEASE EXPLAIN YOUR ADJUSTMENT RELATED TO THE POST-TEST YEAR LAND PURCHASE?

A. BGWC proposed an adjustment to reflect a post-test year purchase of land on which to build a one million-gallon elevated tank in Lake Wylie subdivision. The Company indicates that the purchase of the land will occur prior to construction. While the Company's testimony indicates that the Company proposes to remove this item from the filing, DeStefano Direct Exhibit No. 1, Schedule C - Service Territory 1 and Service Territory 2, Page 2 of 7 shows the inclusion of \$350,000 for the land.

I am recommending an adjustment to remove the cost of the land from rate base. I have removed this cost for two reasons. First, given that the land has not yet been purchased, the amount included in rate base is not known and certain. Second, the purpose for which the land was purchased is to erect an elevated storage tank. Therefore, the cost of the land is part of the storage tank project. Until the project is complete, the land is not considered used and useful. Instead, the land is part of Construction Work in Progress (CWIP). Normally, for ratemaking purposes, CWIP is not eligible for inclusion in rates. Therefore, I am recommending an adjustment to decrease rate base by \$350,000.

Deferred Maintenance Costs in Rate Base

Q. PLEASE EXPLAIN THE COMPANY'S DEFERRED CHARGES CLAIMED IN THIS PROCEEDING?

A. The Deferred Charges included in rate base consists of the unamortized deferred maintenance balances, the removal costs of the Stonegate WTP Decommissioning and the Friarsgate WWTP Decommissioning and the net book value of those decommissioned assets, and TCJA Excess Deferred Income Tax balances.

Q. WHAT ADJUSTMENT ARE YOU PROPOSING TO BLUE GRANITE'S DEFERRED CHARGES CLAIM?

A. BGWC has included the balances of maintenance work related to a wastewater treatment plant tank recoating and various hydro tank inspections which it has classified as deferred maintenance balances. These activities were expected to occur after the end of the test year. I have removed these costs from rate base because they are routine maintenance expenses rather than capital expenditures. While these expenses are not annually recurring expenses, the infrequent nature is not justification to include the costs in rate base.

In addition to the removal of these costs from rate base, I am recommending an adjustment to reduce operating expenses by \$73,000 to remove these costs from the revenue requirement determination. I am removing these costs because they were to be incurred after the end of the test year. Therefore, they are not eligible for recovery in this proceeding.

Amortization of Deferred Assets and Liabilities

Q. WHAT ARE THE DEFERRED ASSETS AND LIABILITIES THAT THE COMPANY IS SEEKING TO RECOVER IN THIS PROCEEDING?

A. In its rate increase filing, BGWC proposes to amortize the costs related to several deferred items on its books. First, the Company indicates that pursuant to this Commission's Order No. 2015-876 in Docket No. 2015-199-WS and the unamortized balance authorized for recovery in Docket No. 2017-292-WS, it has been deferring its purchased water and wastewater treatment costs resulting from rate increases implemented by its third-party providers. It has included deferred costs of \$2,803,968 in this proceeding to be amortized for recovery over a three-year period. The \$2,803,968 is based on actual deferrals through June 30, 2019 and estimated deferred costs through December 31, 2019.

Second, the Company also indicates that it has deferred the litigation expenses related to two cases before the Administrative Law Court involving the DHEC Permit Denial case and the I-20 Interconnection case as required by Commission Order No. 2018-802. The Company is requesting recovery of the related deferred costs of \$216,773 and \$65,948, respectively, over a five-year period.

Third, the Company is proposing to refund this deferred liability of \$335,713 related with the revenue impact of the difference between a 35% federal income tax rate and the 21% federal income tax rate per the TCJA, for the period of January 1, 2018 through the date of the 2017 Rate Case's change in customer rates of June 29, 2018. BGWC proposes to issue a one-time credit of \$10.64 to each customer water and

1 wastewater service account. A customer receiving both water and sewer service would
2 receive a one-time credit of \$21.28.

3 Fourth, BGWC has included in its revenue requirement the removal costs to
4 decommission the Stonegate water treatment plant and the Friarsgate wastewater
5 treatment plant and their respective net book value. For the Stonegate water treatment
6 plant, the company has presented a combined deferred cost of \$756,503 to be amortized
7 over a 19.82-year period. For Friarsgate, the Company has presented a combined
8 deferred cost of \$7,006,490 to be amortized over a 19.72-year period.¹ ,

9 Finally, the Company has also updated its Excess Deferred Income Tax
10 (“EDIT”) balances based on the TCJA’s change in federal income tax rate from 35%
11 to 21%. The updated EDIT reserve balance for protected assets is \$2,742,706 and for
12 unprotected assets is \$111,437 as of December 31, 2019. The updated balance is
13 reflected in base.

14

15 **Q. ARE YOU RECOMMENDING ANY ADJUSTMENTS TO THESE**
16 **DEFERRED ASSETS AND LIABILITIES?**

17 **A.** Yes. As I have shown above, the rate increase sought by the Company is high. In fact,
18 on a consolidated basis, the Company is seeking a 49.1% increase in revenues.
19 Undoubtedly, this increase will have an adverse impact on ratepayers. As means of

¹ The amortization periods are derived based on the weighted average of the remaining lives of the WTP and WWTP assets removed from service.

mitigating the rate increase, I am recommending two changes to the Company's proposal for the amortization of the deferred assets and liabilities. First, I recommend that deferred liability of \$335,713 related to the change in federal income tax as a result of the TCJA be used to offset the deferred purchased water and wastewater treatment costs. In addition, I am recommending that the amortization period for the deferred purchased water and wastewater treatment costs be changed from 3 years to 5 years. The 5-year amortization is consistent with the Company-proposed amortization of the of the Administrative Law Court proceeding and the lengthening of the amortization period serves to minimize the impact of these costs on ratepayers.

Rate Case Expense

Q. WHAT ADJUSTMENT ARE YOU RECOMMENDING TO RATE CASE EXPENSE?

A. BGWC's total rate case expense claim is \$637,273 which it proposes to recover over a three-year period. The \$637,273 amount is composed of \$258,000 related to this proceeding, \$227,077 related to the rehearing of Docket No. 2017-292-WS (the prior rate case) and \$152,196 relate to the unamortized balance of the initial rate case expenses associated with Docket No. 2017-292-WS.

1 On page 23 of Order No. 2018-345(A) issued in Docket No. 2017-292-WS on
2 May 30, 2018, this Commission order on this was as follows:

3 “[BGWC] proposed to include rate case expenses incurred
4 in this rate case through the date of the hearing, and ORS
5 agreed to this proposal, subject to its review of the requested
6 additional amount and examination of supporting
7 documentation. R p. 754 (Payne Surreb., p. 4, ll. 5-7). ORS
8 received and reviewed documentation supporting rate case
9 expenses of \$88,500 and informed the Commission at the
10 hearing that the ORS agrees with them. After the hearing,
11 [BGWC] presented documentation supporting additional
12 rate case expenses of \$64,560. Because the additional rate
13 case expenses are known and measurable, the Commission
14 will allow them to be included in the total rate case expense
15 and amortized over three years. We find the Company is
16 entitled to \$153,060 in total rate case expenses, including
17 those expenses submitted to ORS post-hearing. This amount
18 amortized over three years less the Company’s per book
19 amount yields a post-hearing adjustment of \$21,520.”

20 The amount claimed by the Company in this proceeding related to the prior rate
21 case significantly exceeds this Commission’s findings in the Docket No. 2017-292-
22 WS, in Order No. 2018-345(A). Additionally, the amount associated with the rehearing
23 of the prior rate case exceeds the estimated cost of this rate case, even though the
24 rehearing was limited to a few issues. Therefore, I have adjusted rate case expenses to
25 remove the amounts associated with the prior rate case expenses.

Regulatory Expenses

Q. WHAT ADJUSTMENTS HAVE YOU MADE TO REGULATORY EXPENSES?

A. BGWC has included the cost of the annual filing of the purchased water and purchased wastewater services pass-through proceeding as part of its claim in this proceeding. I disagree with the inclusion of those costs in this proceeding as explained below.

First, it has not yet been established that there would be an annual rate filing for these pass-through costs. Therefore, inclusion of any costs relating to a pass-through proceeding is premature at this time. Second, I believe that the cost of the pass-through proceeding should be recovered as part of the rates established in that proceeding rather than being part of base rates. That is important because it would allow recovery the best estimates of the cost as they are incurred, and it would prevent the Company from recovering costs before they are incurred. Based on the foregoing, I am recommending that the cost of the pass-through proceeding cost not be authorized by this Commission.

Insurance Expense

Q. PLEASE EXPLAIN YOUR ADJUSTMENT TO INSURANCE EXPENSE.

A. BGWC explains that insurance expense was adjusted based on estimated policy premiums and deductible costs as of the time of filing. The Company states that it has since provided updates for the policy premiums determined upon renewal. My review of the Company's insurance claim indicates that there are significant increases in the

1 insurance premiums presented by the Company. In general, insurance premiums are
2 determined based upon an actuarial process rather than escalations based upon
3 calculated growth rates or inflation escalation. Hence, for ratemaking making purposes,
4 I believe it is appropriate to reflect only the actual known insurance premiums rather
5 than estimates. As a result, I am recommending an adjustment to O&M expense to
6 remove the estimated expense presented by the Company.

7

8 **Purchased Water and Wastewater Service Pass-Through Mechanisms**

9 **Q. WHAT IS THE CONSUMER ADVOCATE'S POSITION ON THE**
10 **COMPANY'S PROPOSED PASS-THROUGH MECHANISMS FOR**
11 **PURCHASED WATER AND PURCHASED WASTEWATER SERVICE?**

12 **A.** BGWC recovers its purchased water and wastewater services expenses in base rates.
13 However, the Company defers any increases to purchased water and wastewater
14 treatment costs due to third-party provider rate increases. When a third-party provider
15 increases rates charged to the Company, the Company records the change in cost in a
16 regulatory asset where it is held until it is reflected in base rates.

17 In this proceeding, BGWC is seeking Commission approval of two rate
18 adjustment mechanisms. One would allow annual adjustments to the Company's
19 Distribution Only water rates, and the other would allow adjustments to its Collection
20 Only sewer rates, to reflect changes in third-party vendor rates. BGWC proposes to
21 continue to defer changes in its purchased water and wastewater services expenses until

1 such changes are reflected in retail rates. Under the Company's proposal, it will make
2 an annual filing to adjust rates to pass-through the cost changes to customers.

3 Additionally, there are concerns about unaccounted for water/water losses,
4 allocation of cost recovery among customer classes and the structure and the amount
5 of time allowed to process the annual filing, and BGWC needs to address these issues
6 in its Rebuttal Testimony.

7

8 **Storm Reserve Fund**

9 **Q. WHAT IS YOUR POSITION ON THE COMPANY'S PROPOSAL TO**
10 **ESTABLISH A STORM RESERVE FUND?**

11 **A.** BGWC is seeking authority to establish a Storm Reserve Fund for extraordinary storm
12 restoration costs beyond those included in the Company's revenue requirement. The
13 Company cites Hurricane Florence in September 2018 as an example of the type of
14 storm where the resulting damage would be covered by the fund. The Company
15 proposes to establish a Storm Reserve Fund of \$200,000 which would be funded
16 through a monthly surcharge of \$0.53 per customer. The \$200,000 was determined
17 based upon the costs associated with Hurricane Florence.

18 I do not believe that the establishment of the Storm Fund is necessary at this
19 time. Water utilities, unlike electric utilities, are not particularly vulnerable to hurricane
20 damage since a significant portion of its infrastructure is below ground. Hence,
21 significant costs from hurricane damage is not incurred frequently. In fact, the data

1 presented by the Company shows only one other storm damage cost included in the
2 cost of service, and that storm was a 2016 storm. Given that storm costs are already
3 included in the cost of service, I believe that an adequate allowance has been provided
4 to cover storm damage costs.

5 **Voluntary Round up**

6 **Q. WHAT IS YOUR POSITION ON THE COMPANY'S PROPOSAL TO**
7 **ESTABLISH A VOLUNTARY ROUND UP PROGRAM?**

8 **A.** BGWC is seeking authority to implement a Voluntary Round Up program, which
9 would round participating customer bills to the nearest higher dollar, with the
10 difference being accumulated in a reserve fund for remittance to the South Carolina
11 Office for Economic Opportunity. The funds would be distributed to Community
12 Action Agencies in the Company's service territory to assist low income customers
13 with their water and sewer bills. The Company also seeks approval to defer
14 implementation costs for the Round Up program related to modifications of its billing
15 system and its customer service application, for recovery in the Company's next base
16 rate case.

17 While the Consumer Advocate is not opposed to a program that provides
18 assistance to low income customers, we are opposed to a deferral of costs that assumes
19 automatic recovery in the next rate case. Instead, I am recommending that a cap be
20 placed on the deferral of costs related to modifying the billing system and customer
21 service applications. I am also recommending that this Commission requires the
22 deferred cost to be subject to scrutiny in the Company's next rate case.

1 **Q. DOES THIS COMPLETE YOUR DIRECT TESTIMONY?**

2 **A. Yes, it does.**